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No. 1178

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In the Supreme Court of the United States

October Term, 1941.

OZARK CHEMICAL COMPANY, *Petitioner,*

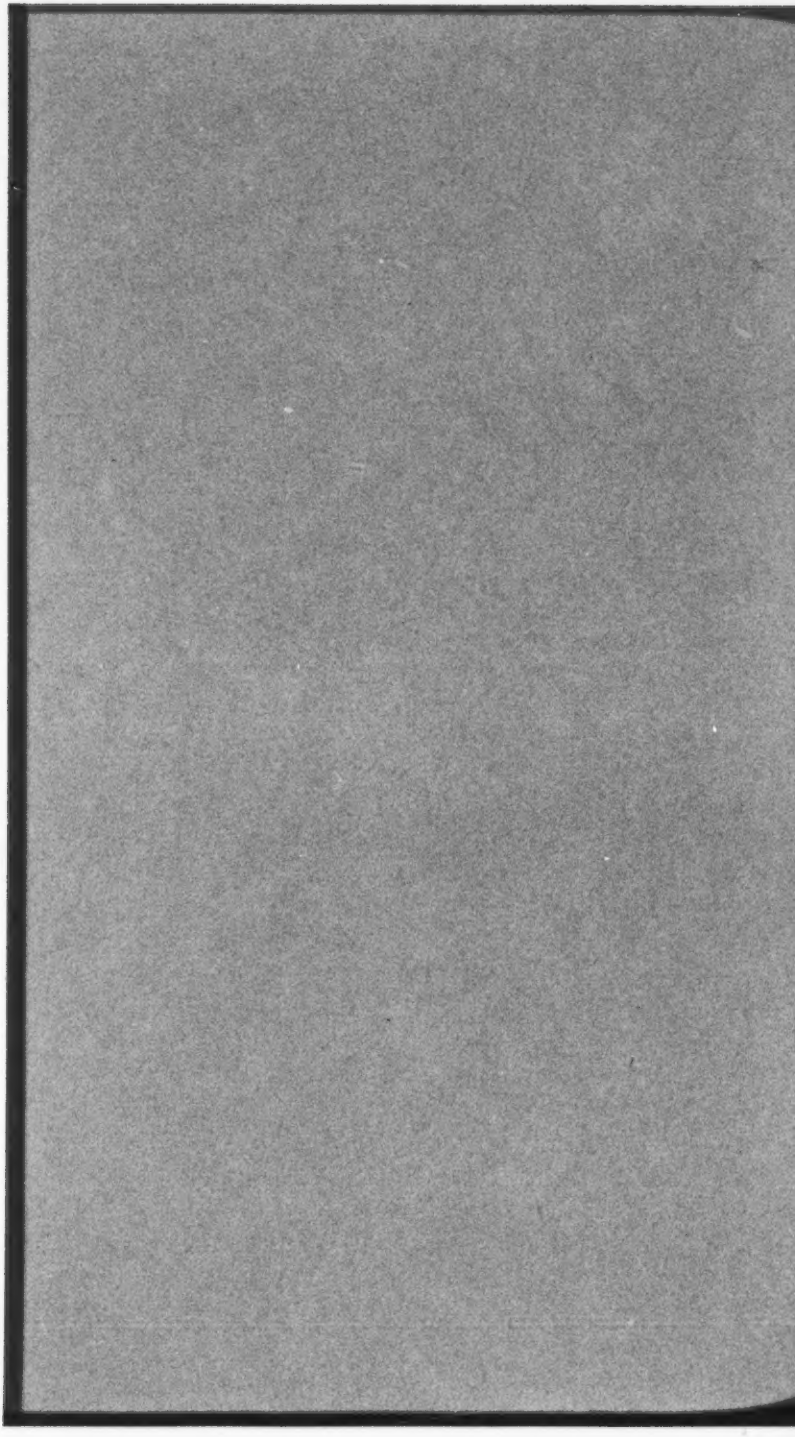
vs.

H. C. JONES, COLLECTOR OF INTERNAL REVENUE,
Respondent.

PETITION FOR A WRIT OF *CERTIORARI* TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE TENTH CIRCUIT.

OZARK CHEMICAL COMPANY,
Petitioner,
By FENELON BOESCHE,
Counsel for Petitioner.

Of Counsel:
ROSCOE E. HARPER,
BRADFORD J. WILLIAMS,
RICHARD P. RYAN.



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IN THE SUPREME COURT OF THE UNITED STATES.
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OZARK CHEMICAL COMPANY, *Petitioner,*

vs.

H. C. JONES, COLLECTOR OF INTERNAL REVENUE,
Respondent.

PETITION FOR A WRIT OF *CERTIORARI* TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE TENTH CIRCUIT.

Petitioner prays that a writ of *certiorari* issue to review the judgment of the United States Circuit Court of Appeals for the Tenth Circuit in the above cause (R. 220-232).

Nature of Action.

This is an action to recover Federal Income Taxes.

Questions Presented.

The questions presented are:

(1) Whether the sodium sulphate deposit which petitioner discovered is a "mine" or "natural deposit of mineral" within the meaning of the "discovery value" depletion provisions of Sections 23(m) and 114(b)(2) of the Revenue

Act of 1934 (48 Stat. 680) and Art. 23 (m)-1(d) and 14 of Regulations 86.

(2) Whether petitioner's valuation of its deposit is supported by the evidence.

(3) Whether, if petitioner erred in fixing the discovery date, such error will result in an excessive depletion allowance to petitioner.

The first question is the only one decided in the majority opinion of the Circuit Court of Appeals for the Tenth Circuit. Circuit Judge PHILLIPS, in his dissenting opinion, found in favor of petitioner on all three questions.

These three questions may be summarized in one: Whether petitioner is entitled to a depletion deduction in its federal income tax return, for the calendar year 1935, based on the "discovery value" of the deposit of sodium sulphate which it discovered.

Sodium sulphate is a natural mineral. It occurs in nature in three forms: *(1)* in an anhydrous form known as thenardite (Na^2SO^4); *(2)* in a hydrated form known as mirabolite ($Na^2SO^4\,10H^2O$), and *(3)* in solution (Na^2SO^4 in solution).

Petitioner's sodium sulphate deposit was discovered, in its natural state, in solution. Respondent contends that sodium sulphate, which in solid form is admittedly a mineral, is not a mineral in solution. The decision of the Circuit Court of Appeals for the Tenth Circuit concedes that sodium sulphate in solution is a "natural deposit" of mineral. (R. 224)

The question, then, is whether petitioner's right to "discovery value" depletion should be denied because its deposit was found in solution rather than in solid form. In other words, should the right to "discovery value" depletion depend on whether a mineral is found in one natural state rather than another.

Summary Statement.

Petitioner is engaged in the chemical business. In 1925, it became aware of an increasing domestic demand for sodium sulphate and began a search for a natural deposit of this mineral. The United States was largely dependent on German importations. During the course of this search, petitioner examined nearly every reported deposit in the United States and Canada (R. 29, 31-34).

In 1930, petitioner sent a representative to Soda Lake, located about 12 miles south of the town of Monahans, Ward County, Texas, to examine reported sodium sulphate crystals in the bed of said lake (R. 34). The crystals were so intermixed with the mud in the lake bed that sodium sulphate could not be recovered in commercial quantities (R. 47-48).

Petitioner decided to drill below the lake bed in the hope of finding additional beds of sodium sulphate crystals (R. 48). The first hole disclosed sodium sulphate in solution containing about 5% sodium sulphate about 30 feet below the surface and another solution containing about 15% sodium sulphate about 100 feet below the surface (R. 37-38). 23 holes were drilled along the exterior boundary of an area of about 2 square miles (R. 67). Petitioner acquired approximately 2700 acres of leases, fee lands and mineral awards at a cost of approximately $2900.00 (R. 35).

In April, 1931, C. O. Anderson, Technical Director for Petitioner, made a preliminary report in which he estimated the sodium sulphate content of the 5% solution at 1,100,000 tons and of the 15% solution at 1,840,000 tons (R. 87).

Petitioner continued its exploration. It subjected the first 23 holes to pumping tests to determine how quickly the solution became exhausted and whether the sodium sulphate content decreased. These holes were pumped until the spring

of 1933 (R. 88). In the meantime, 177 additional holes were drilled inside the first 23 holes to corroborate Anderson's estimate of sodium sulphate tonnage (R. 88). The pumping tests and additional drilling indicated that Anderson's preliminary estimate was sound.

Petitioner's deposit of sodium sulphate in solution is more valuable than if it had been found in solid or crystal form (R. 39). Sodium sulphate is insoluble in very cold water as compared with the other salts with which it is found (R. 41). The only known way to recover sodium sulphate from the other salts with which it is found is to place them in solution and then force out the sodium sulphate crystals by chilling the solution. This recovery method has been known since 1767. It is described in Bulletin 646 published in 1926 by the Montana Department of Mines (R. 42).

While exploration was continuing through pumping tests and additional drilling, petitioner determined that its deposit was favorably located with respect to freight rates from source to market and low cost available fuel (R. 65). Petitioner estimated that it could recover 20,000 tons a year for about 20 years at an average cost of $6.50 a ton and sell same at an average cost of $11.00 a ton f. o. b. plant (R. 45,54). The plant was completed in May, 1933, at a cost of approximately $250,000.00 (R. 45).

Ralph E. Davis, Inc., valuation engineers, prepared a "discovery value" depletion report on petitioner's sodium sulphate deposit (R. 159-174). In its federal income tax return for the calendar year 1935, petitioner claimed a "discovery value" depletion deduction of $3,877.54 based on the sodium sulphate mined and sold that year (R. 195). This deduction was disallowed (R. 210-213). A deficiency of $626.07 was assessed and paid. Claim for refund was filed and denied (R. 122). Petitioner brought this action against respondent on said claim.

Judgment Below.

The trial court found that petitioner had discovered a deposit of sodium sulphate but that such deposit was neither a mine nor a mineral deposit and had no discovery value on the date of discovery (R. 20-26).

An appeal was taken to the United States Circuit Court of Appeals for the Tenth Circuit. The judgment below was affirmed by a divided court, Circuit Judge HUXMAN writing the majority opinion concurred in by Circuit Judge BRATTON (R. 220-224). Circuit Judge PHILLIPS wrote a vigorous dissenting opinion (R. 224-232) wherein he concluded:

> "It seems to me that under the existing emergency when discovery of new mineral deposits is so essential, we should give the statute a broad construction if its language and the applicable regulations permit thereof. I think they do.
>
> "For the foregoing reasons, I think Ozark is entitled to the depletion allowance, and respectfully dissent."

Jurisdiction of This Court to Review the Judgment Below.

(1) The jurisdiction of this court is based upon Judicial Code, Sec. 240(a), as last amended by the Act of June 7, 1934, 48 Stat. 926, U. S. C. A., Title 28, Sec. 347.

(2) This cause involves a construction of Sections 23(m) and 114(b)(2) of the Revenue Act of 1934 (48 Stat. 689, 690, 710), and Art. 23(m)-1(d) and 14 of Regulations 86.

(3) Judgment was entered December 24, 1941 (R. 220-232).

(4) Petition for rehearing was denied February 12, 1942 (R. 238).

Reasons for Granting the Petition.

(1) The decision of the Circuit Court of Appeals for the Tenth Circuit ignores the broad purpose of "discovery value" depletion (see dissenting opinion Circuit Judge PHILLIPS (R. 228, 232)). "Discovery value" depletion was granted to encourage the discovery of new mineral deposits. It has been in effect since the close of the first World War (see Congressional Record, December 17, 1918, p. 549; *Melville G. Thompson*, 10 B. T. A. 25, 30; Paul & Mertens Law of Federal Income Taxation, Vol. 2, Sec. 21.54). This same purpose caused the enactment of the Mineral Leasing Act of February 25, 1920, (41 Stat. 447) which act, incidentally, recognizes that sodium sulphate in solution is a mineral. The wisdom of this policy is demonstrated in the instant case. Petitioner discovered an essential mineral for which the United States was dependent on Germany. Today, the United States again is urging its citizens to discover new mineral deposits. The United States is paying a premium for the production of copper, lead and zinc. The mining of tungsten, quicksilver, manganese, platinum, antimony, chromite, and tin is exempt from corporate excess profits tax in the Revenue Act of 1940.

(2) The decision of the Circuit Court of Appeals for the Tenth Circuit is in conflict with Art. 23(m)-14(b), Regulations 86, issued under the authority of Sec. 23(m) of the Revenue Act of 1934. The decision states (R. 224):

> "It may be conceded, as petitioner contends, that sodium sulphate in solution is a natural deposit within the meaning of the Revenue Act."

Since 1926, the applicable regulations have allowed discovery value depletion "when (1) there is found a natural deposit of mineral." Congress has re-enacted "discovery value" depletion six times without change since 1926 (see

dissenting opinion Circuit Judge PHILLIPS (R. 229-230) and petition for rehearing (R. 233-237)).

(3) The decision of the Circuit Court of Appeals for the Tenth Circuit is in conflict with decisions of this court and other courts in analogous cases. By common usage, the word "mining" has ceased to be confined to the extraction by excavation from the earth of metals and solid minerals. It is now applied to the extraction from the earth of all substances which are classified geologically as "mineral." *In re Great Western Petroleum Corporation,* 16 Fed. Sup. 247, 249 (Dist. Ct. S. D. Cal. 1936). Subterranean waters are minerals. *Hathorn* v. *Natural Carbonic Gas Co.,* 194 N. Y. 326, 87 N. E. 504, 508 (N. Y. Ct. App. 1909). Natural gas is a mineral. *Osborn* v. *Arkansas Territorial Oil & Gas Co.,* 103 Ark. 175, 146 S. W. 122, 129 (1912). Oil is a mineral and its extraction by means of a well is mining. *Burke* v. *Southern Pacific Railway Co.,* 234 U. S. 669 (1913). Mining connotes the removal of minerals from a natural deposit. *Atlas Milling Co.* v. *Jones,* 115 F. (2d) 61, 63 (C. C. A. 10th, 1940).

(4) The Circuit Court of Appeals for the Tenth Circuit has decided an important question of federal income tax law which has not been, but should be, settled by this court. The question presented here is one of first impression and is of growing importance under the "discovery value" depletion provisions of all Revenue Acts since 1918 because of increasing discoveries of minerals in solution.

Petitioner presents herewith a certified transcript of the record in this case in the Circuit Court of Appeals for the Tenth Circuit.

Wherefore, petitioner respectfully submits that this petition should be granted.

OZARK CHEMICAL COMPANY,
Petitioner,

FENELON BOESCHE,
Counsel for Petitioner.

Of Counsel:
ROSCOE E. HARPER,
BRADFORD J. WILLIAMS,
RICHARD P. RYAN.

CERTIFICATE OF COUNSEL.

I, one of counsel for the above named petitioner, do hereby certify that I have read the foregoing petition for writ of *certiorari* and that in my opinion such petition is well founded and is entitled to the favorable consideration of the court.

FENELON BOESCHE.

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In the Supreme Court of the United States

OCTOBER TERM, 1941

No. 1178

OZARK CHEMICAL COMPANY, A CORPORATION, PETITIONER

v.

H. C. JONES, COLLECTOR OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE TENTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The District Court for the Western District of Oklahoma rendered no opinion. The opinions of the Circuit Court of Appeals for the Tenth Circuit (R. 220–232) are reported in 125 F. (2d) 1.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered December 24, 1941 (R. 232). A petition for rehearing was denied February 12, 1942 (R. 238). The petition for a writ of certiorari was filed April 25, 1942. The jurisdiction of this

Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

The ultimate question is whether the petitioner is entitled, under Sections 23 (m) and 114 (b) (2) of the Revenue Act of 1934, to a deduction on account of depletion of a deposit of sodium sulphate in solution on a discovery value basis. This question in turn depends on whether the petitioner's brine wells containing sodium sulphate in solution are a mine within the meaning of Section 114 (b) (2).[1]

STATUTES AND REGULATIONS INVOLVED

The statutes and regulations involved are set out in the Appendix, *infra,* pp. 8–12.

STATEMENT

The pertinent facts as found by the District Court may be summarized as follows:

In its income tax return for the calendar year ended December 31, 1935, the petitioner claimed a discovery depletion deduction as of June 30, 1933, on account of sodium sulphate recovered by it from its wells, and paid the tax on the balance

[1] If this question were answered in the negative, there would be presented the further question whether the finding of the District Court that the deposit had no fair market value on the date of discovery was supported by substantial evidence.

of its net income.[2] The Commissioner denied the deduction and determined a deficiency against the petitioner in the sum of $626.07. The petitioner paid the deficiency, and after filing its claim for refund, instituted this action in the District Court. (R. 23.)

Prior to April 30, 1931, petitioner engaged in drilling tests within and around a sodium lake bed in Texas during 1930 and 1931 (R. 20–22). Its tests disclosed the presence of brines containing sodium sulphate in solution (R. 21). Experiments were begun to develop a method of separating sodium sulphate from the brines in solution (R. 22).

The District Court found that since it was necessary to process the brine, value was not inherent in the brine alone, and that the value of the brine as a potential source of sodium sulphate as of April 1, 1931, was impossible of determination (R. 22). It further found that the pumping of brine from wells did not constitute a mining operation, and that brine was not a mineral (R. 22–23). Judgment was, accordingly, entered for the respondent (R. 25–26). The court below, Judge Phillips dissenting, affirmed on the ground that the brine well did not constitute a mine and the brine solution was not a mineral (R. 220–232).

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[2] The total alleged discovery depletion deduction was $8,775.67. Since petitioner's net income for the year from the operations in controversy was $7,755.08, petitioner was limited to a deduction of 50% of the income, or $3,877.54 (R. 23).

ARGUMENT

Section 23 (m) of the Revenue Act of 1934 (Appendix, *infra,* pp. 8–9) permits a reasonable allowance for depletion in computing net income in the case of (1) "mines"; (2) "oil and gas wells"; (3) "other natural deposits"; and (4) "timber." While Section 114 (b) (1) (Appendix, *infra,* p. 9) prescribes cost as the general basis for depletion allowance, Section 114 (b) (2) (Appendix, *infra,* pp. 9–10) provides that the basis for depletion in the case of mines (other than metal, coal, or sulphur mines) discovered by the taxpayer after February 28, 1918, shall be the fair market value of the property at the date of discovery or thirty days thereafter, if such mines were not acquired as the result of purchase of a proven tract or lease, and if the fair market value of the property is materially disproportionate to the cost.[3]

1. Since the discovery value depletion granted by Section 114 (b) (2) is limited only to "mines" and not to the remaining three categories permitted depletion allowances by Section 23 (m), the dispositive issue is whether petitioner's brine wells are "mines" within the meaning of those sections. We submit that the concurrent holdings of the courts below that the brine wells here in-

[3] The District Court found (R. 22) that petitioner's drilling prior to April 1, 1931, disclosed brine in solution of a potential value disproportionate to the actual investment of the parties.

volved are not "mines," are correct and do not warrant further review.

The brine wells here involved do not fall within the ordinary concept of a "mine." As the court below observed (R. 221), the normal meaning of the word is an excavation in the earth from which ores, as well as other substances such as coal, are removed by digging.[4] Pumping brine into receptacles and removing the mineral substances from the brine by condensation or evaporation is far removed from what is commonly denoted as "mining." Moreover, the courts below found that the brine said by petitioner to have been "mined" was not "a mineral"; the concurrent findings on this issue are fully supported by testimony of expert witnesses (see R. 125–126, 128, 134, 138).

That Congress intended to limit the meaning of the word "mines" in this manner appears from Sections 23 (m) and 114 (b) (2). Section 23 (m) separately lists "mines," "oil and gas wells," and "other natural deposits" but Section 114 (b) (2) applies only to "mines." It would seem clear, therefore, that "mines" do not include "oil and gas wells," to which the brine wells are more nearly analogous, or "other natural deposits", in which category brine containing the sodium sulphate solution apparently falls. Congress, therefore,

[4] See White on *Mines and Mining* (1903), Secs. 1 and 2; Lindley on *Mines* (3d ed.), Vol. 1, Secs. 88 and 89; Shamel on *Mining, Mineral and Geological Law* (1907), 17–18.

seems to have intended to identify "mines" in the normal and restricted sense as excavations, whether by tunnels, shafts, or open cuts which men enter to dig out the mineral deposits. This is the normal meaning of the words. Cf. *Atlas Milling Co.* v. *Jones,* 115 F. (2d) 61, 63 (C. C. A. 10, 1940), and cases there cited.[5]

2. But even if the brine wells were held to be mines and the brine a mineral, petitioner must fail since there was substantial evidence to support the findings of the District Court (R. 21–22, 24) that the value of the potential source of sodium sulphate as of the basic date could not be determined, and that development of a profitable method of recovery was essential before the economic usefulness of the brine could be demonstrated. The record fails to establish that the brines *per se* have any economic or intrinsic value (R. 59, 66, 67, 102). Since the brines had no demonstrable intrinsic value on discovery, and became valuable only as a result of the perfection on or after June 30, 1933 (cf. R. 22, 24) of a process for the commercial extraction of the sodium sulphate from the brine, petitioner has not brought itself

[5] Petitioner's suggestion (Br. 7) that the decision below is in conflict with the decision of this Court in *Burke* v. *Southern Pacific R. R. Co.*, 234 U. S. 669, is mistaken. That case did not involve Sections 23 (m) and 114 (b) (2) of the Revenue Act but dealt with the issue whether oil-bearing lands were mineral lands within the meaning of the Southern Pacific Land Grant Act which excepted such lands.

within the provisions of Section 114 (b) (2) and Art. 23 (m)–14 of Treasury Regulations 86 (Appendix, *infra,* pp. 11–12), even if the brine wells were mines and the brine a mineral.

CONCLUSION

The decision of the court below is correct, and there is neither any conflict nor any question which now warrants further review. It is respectfully submitted that the petition for certiorari should be denied.

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CARLTON FOX,
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MAY 1942.

APPENDIX

Revenue Act of 1934, c. 277, 48 Stat. 680:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * * *

(m) *Depletion.*—In the case of mines, oil and gas wells, other natural deposits, and timber, a reasonable allowance for depletion and for depreciation of improvements, according to the peculiar conditions in each case; such reasonable allowance in all cases to be made under rules and regulations to be prescribed by the Commissioner, with the approval of the Secretary. In any case in which it is ascertained as a result of operations or of development work that the recoverable units are greater or less than the prior estimate thereof, then such prior estimate (but not the basis for depletion) shall be revised and the allowance under this subsection for subsequent taxable years shall be based upon such revised estimate. In the case of leases the deductions shall be equitably apportioned between the lessor and lessee. In the case of property held by one person for life with remainder to another person, the deduction shall be computed as if the life tenant were the absolute owner of the property and shall be allowed to the life tenant. In the case of property held in trust the allowable deduction shall be apportioned between the income beneficiaries and the trustee in accordance with the pertinent provisions of

the instrument creating the trust, or, in the absence of such provisions, on the basis of the trust income allocable to each. * * *

* * * * *

SEC. 114. BASIS FOR DEPRECIATION AND DEPLETION.

* * * * *

(b) *Basis for Depletion.*—

(1) *General rule.*—The basis upon which depletion is to be allowed in respect of any property shall be the adjusted basis provided in section 113 (b) for the purpose of determining the gain upon the sale or other disposition of such property, except as provided in paragraphs (2), (3), and (4) of this subsection.

(2) *Discovery value in case of mines.*—In the case of mines (other than metal, coal or sulphur mines) discovered by the taxpayer after February 28, 1913, the basis for depletion shall be the fair market value of the property at the date of discovery or within thirty days thereafter, if such mines were not acquired as the result of purchase of a proven tract or lease, and if the fair market value of the property is materially disproportionate to the cost. The depletion allowance under section 23 (m) based on discovery value provided in this paragraph shall not exceed 50 per centum of the net income of the taxpayer (computed without allowance for depletion) from the property upon which the discovery was made, except that in no case shall the depletion allowance under section 23 (m) be less than it would be if computed without reference to discovery value. Discoveries shall include minerals in commercial quantities contained within a vein or deposit discovered in an existing mine or mining tract by the

taxpayer after February 28, 1913, if the vein or deposit thus discovered was not merely the uninterrupted extension of a continuing commercial vein or deposit already known to exist, and if the discovered minerals are of sufficient value and quantity that they could be separately mined and marketed at a profit.

* * * * *

Treasury Regulations 86, promulgated under the Revenue Act of 1934:

ART. 23 (m)–1. *Depletion of mines, oil and gas wells, other natural deposits, and timber; depreciation of improvements.*—* * *

* * * * *

When used in these articles (23 (m)–1 to 23 (m)–28) covering depletion and depreciation—

* * * * *

(c) A "mineral deposit" refers to minerals only, such as the ores only in the case of a mine, to the oil only in the case of an oil well, and to the gas only in the case of a gas well, and to the oil and gas in the case of a well producing both oil and gas. The cost of a mineral deposit is that proportion of the total cost of the mineral property which the value of the deposit bears to the value of the property at the time of its purchase.

(d) "Minerals" include ores of the metals, coal, oil, gas, and such nonmetallic substances as abrasives, asbestos, asphaltum, barytes, borax, building stone, cement rock, clay, crushed stone, feldspar, fluorspar, fuller's earth, graphite, gravel, gypsum, limestone, magnesite, marl, mica, mineral pigments, peat, potash, precious

stones, refractories, rock phosphate, salt, sand, silica, slate, soapstone, soda, sulphur, and talc.

* * * * *

ART. 23 (m)–14. *Discovery of mines other than coal, metal, or sulphur mines.*—(a) To entitle a taxpayer to a valuation of his property, for the purpose of depletion allowances, by reason of the discovery of a mine (other than a coal, metal, or sulphur mine) or minerals (other than oil or gas, coal, sulphur, metal, or metallic ores), it must appear that the mine or minerals were not acquired as the result of the purchase of a proven tract or lease; also, the discovery must be made by the taxpayer after February 28, 1913, and must result in the fair market value of the property becoming disproportionate to the cost. The fair market value of the property will be deemed to have become disproportionate to the cost when the newly discovered minerals are of such quantity and of such quality as to afford a reasonable expectation of return to the taxpayer of an amount materially in excess of the capital expended in making such discovery plus the cost of future development, equipment, and exploitation.

(b) A mine or minerals of a kind not excepted by this article may be said to be discovered when (1) there is found a natural deposit of mineral, or (2) there is disclosed by drilling or exploration, conducted above or below ground, a mineral deposit not previously known to exist and the existence of which was so improbable that such deposit had not and could not have been included in any previous valuation for the purpose of depletion, and which in either

case exists in quantity and grades sufficient to justify commercial exploitation.

(c) In determining whether a discovery entitling the taxpayer to a valuation has been made, the Commissioner will take into account the peculiar conditions of each case; but no discovery, for the purposes of depletion, can be allowed as to minerals which constitute merely uninterrupted extensions of continuing commercial veins or deposits already known to exist, which have been or should have been included in "probable" or "prospective" mineral, or which were in any other way comprehended in a prior valuation, nor can a discovery, for purposes of depletion, be allowed as of a date subsequent to that when, in fact, discovery was evident, when delay by the taxpayer in making claim therefor has resulted or will result in excessive allowances for depletion.

(d) Discoveries include minerals in commercial quantities contained within a vein or deposit discovered in an existing mine or mining tract by the taxpayer after February 28, 1913, but such vein or deposit must not be merely the uninterrupted extension of a continuing commercial vein or deposit already known to exist, and the newly discovered minerals must be of sufficient value and quantity that they could be separately mined and marketed at a profit.

(e) The value of property claimed as the result of a discovery must be the fair market value, as defined in article 23 (m)–7, based on what is evident within 30 days after the commercially valuable character and extent of the discovered deposits of mineral have with reasonable certainty been established, determined, or proved.

U. S. GOVERNMENT PRINTING OFFICE: 1942